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UNCLAS SECTION 01 OF 02 PARIS 000381

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E.O. 12958: N/A
TAGS: EFIN ECON PGOV FR PBIO
SUBJECT: EURONEXT BIDS ON THE LONDON STOCK EXCHANGE

Ref: (A) Paris 008800; (B) Frankfurt 10640

¶1. SUMMARY. Paris-based Euronext, the first cross-border European exchange, has launched talks to buy the London Stock Exchange (LSE), after the LSE rejected an informal approach from Deutsche Borse (DB, ref B). If the bid is accepted, Euronext will realize its ambitions (ref A), becoming the biggest stock market operator in Europe, and the second biggest in the world after the NYSE. Acquisition of LSE by DB or Euronext would favor a more integrated European securities market. It would also confirm London, not Paris or Frankfurt, as the center of European financial operations, but could also boost the pro-euro camp in the UK and push the UK a bit closer to euro entry. END SUMMARY.

Euronext bids on the London Stock Exchange

¶2. Euronext, which was formed by the merger of the stock exchanges of Paris, Brussels, and Amsterdam in September 2000, with the Lisbon stock exchange in 2002, and the purchase of the London-based options and futures exchange LIFFE, launched a bid for the London Stock Exchange (LSE) just after LSE rejected a 2-billion euro offer from Deutsche Borse (DB). A Euronext official confirmed that the company has been working on a possible bid with its advisers Morgan Stanley, UBS, ABN Amro, and BNP-Paribas.

¶3. Euronext is working on an all-cash offer that is expected to come in above the 530 pence-a-share indicative offer (2 billion euros) made by DB on December 11 (ref B). The CEO of Euronext, Jean-Francois Theodore, held private talks with Clara Furse, his LSE counterpart to spell out his interest in making a bid.

¶4. Euronext, which is organized under Dutch law, will need approval from its shareholders to make its bid. According to new Dutch regulations, the acquisition of a stake of more than 33% in a company requires the green light from shareholders. Banks, which historically possess most of Euronext's shares, are not all favorable to the overtures to LSE. According to press reports, DB has secured approval of a possible takeover from its supervisory board, although some of its shareholders are showing some resistance.

Euronext Advantages over DB

¶5. Euronext is already present in London due to its acquisition of Liffe in 2001. Euronext also already has a foot in the door as the biggest individual shareholder (with a 41.5% stake) of LCH Clearnet, a merger of the London and Euronext clearing systems, and the first European clearing and central counter-party services provider. Euronext claims it is the only European market that has successfully integrated its operations with that of others in other countries (NOTE: DB's model is to place its trading screens in other countries - providing "cross border" access to its trading platform - a different business strategy than Euronext's, but still effectively cross border. END NOTE). Perhaps most important, Euronext has signaled it is prepared to move its headquarters from Paris to London. A Euronext official said "Sitting in London is likely to win favor from the LSE's customers, its board, politicians and the Financial Services Authority."

Stakes are High for Euronext

¶6. French analysts have noted that in not making a bid for LSE, Euronext would miss the opportunity of getting its hands on the largest liquidity pool in Europe. A deal with LSE would have an immediate impact for Euronext, since LSE is Europe's biggest stock market with a total 2.1 trillion euro capitalization. A deal with LSE would offer issuers and investors access to more liquidity, reduced costs and

more efficiency. If Euronext's bid is rejected, it could also find itself deprived of LCH Clearnet income, and lose equity derivatives market share.

Other Fish in the Sea

¶7. If Euronext is set on expansion, it could simply choose a strategy to develop further computerized services. Another possibility would be to associate, acquire or merge with southern or east European stock exchanges. According to financial industry insiders, Euronext has been in talks to buy pan-European bond trading platform MTS Group. London-based EuroMTS, which is part of the Milan-based MTS group, handles more than 50% of euro-zone government bond trading. Euronext officials have refused to comment, except to say that there is no link between the MTS rumors and talks with the LSE. In 2004, the MTS group was looking for a partner able to give it the financial means to accelerate its development. The acquisition of MTS by Euronext would be expensive (MTS posted 70 million euro sales and a high rate of growth in 2004), depriving Euronext of funds it might need to acquire LSE. Nevertheless, Euronext could reinforce its position on the European government bond market if it acquires the MTS platform.

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LSE Waits and Sees, Ready to Examine Proposals
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¶8. LSE said it plans to continue its negotiations with suitors as "the approach is an early stage and therefore does not require a response at this point." According to the Financial Times, "the decision is likely to come down to personalities and strategic direction - plans to offer derivatives trading alongside equities trading." Euronext could officially confirm its bid in early 2005 as its advisers are sounding out LSE's customers to ensure they are comfortable with the structure.

Comment

¶9. A deal with either DB or Euronext will create the biggest stock market operator in Europe, and the second biggest after the NYSE. Consolidation of share trading will have significant implications for integrating European securities markets (ref B). If Euronext's proposal is accepted by LSE, Euronext could realize its grand ambitions (ref A), but London would realize the mixed impact of maintaining its presence as the key European financial center while becoming more integrated into the EU fold and thus less independent.

¶10. This message has been coordinated with and cleared by Embassy London and the Financial Attache, Frankfurt.
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